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CAR - Avis Budget Group Inc at Deutsche Bank Leveraged Finance Conference

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PRESENTATION

Sean Wondrack - *Deutsche Bank - Analyst*

Good morning, everybody, and welcome to the 24th annual Deutsche Bank high-yield conference in Scottsdale, Arizona. My name is Sean Wondrack, and I'm a high-yield analyst covering metals and mining as well as rentals.

Here with me this morning, we are excited to have management from Avis Budget group, led by David Wyshner, President and CFO; and Neal Goldner, Vice President of Investor Relations. The format for today's discussion will be Q&A. We will begin with some remarks from David, and then we will go into a Q&A session. Thanks for attending.

David Wyshner - *Avis Budget Group, Inc. - President and CFO*

Thanks, Sean, and thanks very much for joining us today. And also thank you very much for Deutsche Bank for inviting us once again to present at this conference. I think it's the 10th time in the last 11 years we've been here.

Avis Budget Group is the leading global provider of vehicle rental services. We generate nearly $9 billion in annual revenue, primarily through our Avis Budget and Zipcar brands.

We operate directly in 25 countries -- primarily in the Americas and Europe, plus Australia, and we have licensees in more than 150 countries around the world. We have more than $3 million in corporate debt and more than $10 billion of asset-backed debt outstanding.

Last year, we generated more than $900 million of EBITDA, and earnings were more than $3.00 a share. We had our fourth straight year with free cash flow of more than $450 million, and we just celebrated our 10th anniversary as an independent publicly-traded company.

Automotive technology and vehicle services are evolving rapidly, and we're playing an active role in this evolution. We are using increasingly sophisticated yield management software to optimize our pricing, and we will begin using state-of-the-art integrated demand fleet pricing models in the next several months.

We have recently rolled out Avis Now, an industry-leading app that allows customers to control virtually all elements of their vehicle rental from their smartphone or tablet -- all the way from reservation, to rental, to return, including vehicle choice. Nearly 0.25 million people have already downloaded the app and registered to use Avis Now.

The feedback from folks who have used it to rent a vehicle has been excellent, and we are already working on enhancements and improvements for the next iteration of Avis Now -- particularly in how we present ancillary products. Even beyond our Demand-Fleet-Pricing project in Avis Now, we are investing $100 million a year in information technology to modernize our systems; launch new websites and upgraded apps; enhance the customer experience; build customer loyalty; optimize our fleet acquisition and disposition activities; and drive efficiencies in our business.

Ours is a growing business. While our revenue growth is forecasted to be low-to-mid single digits in percentage terms, we do expect to generate more than $250 million in incremental revenue this year compared to last.

Our Zipcar brand continues to be the world's leading car-sharing network and recently passed the 1 million member milestone. Zipcar is a unique and valuable asset, particularly amid the recent proliferation of vehicle services companies. We believe it is the only company that has proven its ability to allow people to successfully share vehicles without a company representative being present for the transaction, and to do so both at scale and profitably.

We are rapidly expanding Zipcar's service offerings to be able to provide reserved one-way and floating capabilities in addition to Zipcar's traditional round-trip transactions. This will allow us to continue to be a leader in providing urban mobility solutions.

At the same time, the increased levels of third-party investment in automotive technology over the last few years has caused us to realize something related to our capabilities as a company: there is a tremendous and innate physicalness to allowing a car to be shared or rented by multiple parties -- the need for maintenance, and cleaning, and gas; the likelihood of flat tires, and broken windshields, and other vehicle damage; the possibility of vehicle theft, and parking tickets, and impounding; the prevalence of manufacturer recalls; the need for the car to be parked somewhere safe when it's not being used; the need for the car or a replacement to be available, on time and in the right place, for the next user; the acquisition, and licensing, and disposition of vehicles and so forth.

And what we have realized is that we are one of a small number of companies in the world with these large-scale fleet logistics capabilities. And we believe our capabilities in this area become more valuable, not less, as pay-to-use business models grow in the vehicle services space.

I guess that's a long way of saying that there's a lot more work to managing a fleet of shared vehicles than some people realize. We're remarkably good at it, and we will look to find additional ways to serve customers' needs and derive value from our capabilities going forward.

Separately, I also want to provide an update on our summer. In the Americas, the summer travel season ended up being pretty good. Summer pricing was positive year-over-year, consistent with our expectations.

Vehicle residual values have been stable. Car rental demand and volumes have been just under what we anticipated. We continue to manage our fleet carefully, and our post-summer peak defleeting in late August and September has gone according to plan.

In Europe, the August peaks was disappointing -- sorry, it landed here and not on the page. While our European revenue increased year-over-year, inbound demand was soft all along the Mediterranean. And that negatively impacted pricing in France, Italy, and Spain, particularly for those of us who had tried to avoid filling up early on lower-priced business. Trends in July had been largely tracking our expectations, so we weren't anticipating the imbalance between supply and demand that developed and negatively impacted peak pricing across the industry in August.

For what it's worth, my sense is that this softness was driven more by security concerns than by the Brexit vote, or the Olympics, or the broader economy -- but all four probably played a role. I'd put the negative impact of the disappointing August on international EBITDA in the single-digit millions range compared to our expectations for the month.

The silver lining would be that in-country rental volumes were okay, and the rest of the year in Europe is more dependent on commercial business than on leisure travelers, so we would not expect the impact in future months to be at all like what we saw in August. Generally speaking, then, macro trends in the Americas have remained consistent with our expectations, while it's fair to say that we have now joined many other global travel providers in being more cautious about our international segment due to reduced travel demand in Europe.

Notwithstanding these challenges in Europe, we remain enthusiastic about our business. We are achieving positive pricing in the Americas. Our customers are embracing our Avis Now app and additional service offerings at Zipcar. We are making good progress on our Demand-Fleet-Pricing initiative, on our manpower and shuttling initiatives, and on several other projects -- all of which should be a help to us in 2017.

We are investing in our business, holding our fleet relatively tight, and managing our expenses and our balance sheet carefully. Our corporate debt maturity profile is in great shape, with only $400 million of debt coming due before 2021. And most importantly, we feel that we are well positioned for success in our industry.

Sean Wondrack - *Deutsche Bank - Analyst*

Thank you, David. That was very helpful.

So US economic growth has been relatively sluggish the past few years, evident in 2Q 2016 [sprint] slightly north of 1%. Since the car rental industry has historically grown at a multiple of GDP, call it 1.5 times, the lackluster environment has made it more difficult for companies to capitalize on their leverage to an expanding economy. In your experience, how has Avis Budget worked to overcome the challenges of this slow-growth economic up cycle?

David Wyshner - *Avis Budget Group, Inc. - President and CFO*

Sure. We're managing costs to drive margins, and that's a key part of what -- of how we're addressing the issue of slower growth. We are growing faster outside the United States, especially in Europe. We are growing our membership at Zipcar. And we're supplementing organic growth with a few tuck-in acquisitions. So those are all helping us grow, but we're really focused on managing costs to get as much as we can out of the growth that's out there.

Sean Wondrack - *Deutsche Bank - Analyst*

Moving along, the US car rental market had a challenging first half in 2016 but has shown signs of recovery as of late. Avis Budget had somewhat of a difficult first quarter before recovering nicely in Q2 and raising the midpoint of full-year guidance. Can you describe for us what happened in the first half and what has changed your outlook to improve for 2H 2016?

David Wyshner - *Avis Budget Group, Inc. - President and CFO*

Sure. We saw an incredibly difficult pricing environment in the first quarter that improved dramatically as we moved into the second quarter, and our full-year earnings forecast reflects the continuation of positive pricing that we saw in the second quarter. And in particular, our full-year earnings forecast actually implies 8% to 17% EBITDA growth in the second half of the year.

Sean Wondrack - *Deutsche Bank - Analyst*

And when you think about some of the trends you were just speaking about that occurred during the summer, how does the business in the Americas weight relative to the business in Europe? So if pricing is up in the Americas, is that weighted towards more of the whole portfolio, because the Americas is a larger share of your business?

David Wyshner - *Avis Budget Group, Inc. - President and CFO*

Absolutely. About 65% of our revenue is in the Americas; the remaining third or so outside of the US. And as a result, the trends in the Americas -- and particularly pricing -- end up having an outsized impact on our overall results. So that driver, that dynamic of increased pricing in the Americas that we've been seeing, I think, ends up being the most important one.

Sean Wondrack - *Deutsche Bank - Analyst*

An important initiative you guys have going on -- actually, you mentioned it in your prepared remarks -- is your Demand-Fleet-Pricing initiative. Can you describe: what is it? What has Avis Budget achieved to date? And do you foresee additional opportunity to further improve pricing and yield?

David Wyshner - *Avis Budget Group, Inc. - President and CFO*

Absolutely. This is one of my favorites. Our Demand-Fleet-Pricing project is a three-phase initiative. The first phase is a pricing robotic that allows us to update millions of prices, millions of price points, each day, multiple times a day, based on how we want to position ourselves relative to competitors' pricing in the industry.

The second phase, which we've been working on for the last year-plus, is the buildout of a detailed demand forecaster by market, which enables us to move into the third phase, which is the use of algorithms and an optimization model to manage fleet and pricing dynamically, based on the demand forecast as well as competitive pricing in the industry.

We think the initiative overall should be worth 1 point of price and 1 point of utilization to us. We are achieving a significant portion of that already through the pricing robotic. And as we move into 2017 and begin to roll out phases two and three, we expect to get the remainder of that -- of those increases in utilization and in pricing.

Sean Wondrack - *Deutsche Bank - Analyst*

Thank you. On the second-quarter call, you commented that you had already sold three-quarters of the fleet that you had anticipated selling thus far in 2016. How does the timing of your sales in 2016 compare to prior years? And was this year more of a function of taking advantage of stronger residual markets?

David Wyshner - *Avis Budget Group, Inc. - President and CFO*

Yes. Over the last three years, we've looked to find opportunities to sell more and more cars earlier in the year while still meeting the summer peak needs that we have. I think the used car market this year was again supportive of that.

And what it's allowing us to do is better optimize our fleet management as well as reduce our risk associated with where residual values are after the summer peak. So we've moved up considerably from where we were five or six years ago, and then we've tweaked that up even further over each of the last two or three years to really take advantage of the peak or best times for us to be selling vehicles -- selling a lot more cars in the mid-February to May or June time frame; taking care of most of our risk, our dispositions, in the first half of the year; and reducing the amount that we need to be selling in the fourth quarter. The number of remaining risk car sales is really going to be quite small for us in Q4.

Sean Wondrack - *Deutsche Bank - Analyst*

That's actually a great lead-in to the next question. How do you determine the right percentage of risk versus program cars you purchase each year? And what do you look at when you're evaluating relative value when you make decisions?

David Wyshner - *Avis Budget Group, Inc. - President and CFO*

Sure. It's really an optimization exercise for us to look at the right way to get the number of cars we need each month, not to hold onto cars longer than we are comfortable with, and balancing the benefits in terms of flexibility and the cons of higher costs associated with program cars versus taking on the risk associated with risk cars.

Where we end up -- where we've ended up over time is, roughly speaking, about two-thirds risk, one-third program. As we move into 2017, I think we'll be a little bit higher than that, at 70% or more risk cars in 2017. And again, it's not necessarily about having -- it's not about having a view that we are targeting a percentage of X, but rather looking at the relative costs and benefits and optimizing.

And this year the program deals, in our view, weren't quite as attractive as some of the risk deals that were out there. So we've moved up our risk percentage a little bit as we move into 2017.

Sean Wondrack - *Deutsche Bank - Analyst*

Avis has also been very active this year in disposing of vehicles through alternative disposition channels other than auction. Going forward, is this a trend you expect to increase over time? And is there a rough benchmark we should think about in terms of percentage of cars sold via auction versus alternatives?

David Wyshner - *Avis Budget Group, Inc. - President and CFO*

That's absolutely right. We have been significantly increasing the number of risk cars that we sell through alternative disposition channels -- anything other than a physical auction site. We are increasing the number of dealers to whom we sell vehicles directly, our dealer direct sales. We are selling more cars on a wholesale or dealer basis through online auctions, and we are also ramping up the cars that we sell directly to consumers, even though that's a very small portion of what we do.

When you put these alternative channels together, they are now running at more than 40% of our vehicle dispositions. We think we're generating a several hundred dollar benefit per car on the vehicles that we are selling this way. And we're going to look to continue to increase this over time.

I don't know if there's a natural limit on the percentage that we can sell; I think we will continue to use physical auction sites, wholesale auction sites to some extent going forward. But we're going to look to continue to grow these alternative disposition channels as long as we can make more money by doing so.

Sean Wondrack - *Deutsche Bank - Analyst*

Thank you. And then switching gears a little bit, can you talk a little bit about how you manage your commercial business versus how you manage your leisure rentals? And what pricing trends should investors anticipate on the leisure and commercial side in the back half of 2016, please?

David Wyshner - *Avis Budget Group, Inc. - President and CFO*

Sure. I think commercial and leisure travel are symbiotic for our business. Certain days of the week are obviously more leisure-oriented than others, some weeks of the month, some seasons of the year.

And what the two principal components of our business allow us to do is to share fleet between them. So we really view the two pieces as symbiotic and core and almost inseparable parts of what we do.

Certainly over the last few years the leisure side of that coin has been the stronger one, with better growth and better pricing on the leisure side. I think that's likely to continue. But we see good opportunities on the commercial side as well. The large commercial business tends to be highly competitive, but we see opportunities in the middle market, and smaller business at times, and government business as ways to continue to achieve growth and good profitability on the commercial side of the business as well.

I think our brands naturally play to the various pockets of demand that are out there as well -- with the Avis brand, obviously, resonating very well with commercial travelers and commercial travel managers. And at the same time, the Budget brand's skewing more toward the leisure side of the house. So we use our brands to seize the various pockets of demand that are out there and increase fleet utilization.

Sean Wondrack - *Deutsche Bank - Analyst*

Thank you. Just on the commercial side of your business, how would you characterize today's competitive environment versus five years ago? Are you seeing any pressure as you try to renew customer contracts at higher rates?

David Wyshner - *Avis Budget Group, Inc. - President and CFO*

Yes. Particularly on the large commercial side, we continue to see a significant competitive pressure. It's even more intense than it was three or five years ago. And we are fortunately well positioned in terms of the relationships and customer satisfaction that we have in our large accounts.

We really need to balance those with good growth and good profitability from midsize and smaller businesses. The nature of small business accounts is that their travel patterns look an awful lot like those of larger businesses. We're just not required to provide the same level of volume discount to capture that business, and that makes it very attractive for us. So I think you'll see us continuing to increase and expand our focus in that area.

Sean Wondrack - *Deutsche Bank - Analyst*

Moving forward, so the landscape for auto rental is constantly evolving, and technology is playing an ever-increasing role in day-to-day operations. Can you please describe Avis Now as well as any more of the more important technological initiatives you are currently piloting?

David Wyshner - *Avis Budget Group, Inc. - President and CFO*

Sure. As I mentioned, Avis Now is an important technology thrust for us right now. It's a customer-facing app that allows travelers to control virtually all elements of the rental, from reservation, to rental or check-out, to return, to -- including vehicle choice. And that combination of features and control is really resonating well with the travelers who have used it. We're excited about the feedback we're getting, and we think we're state-of-the-art in our industry in terms of the customer experience we're providing through the app.

And even so, we're not resting on our laurels. We're working on version 2.0 already. We think there are some additional features that customers want. We can do a better job of presenting ancillary revenues.

And even as some customers are using the app to upgrade their vehicles, we think there may be even opportunities for more customers to do that. And I think as we continue to work with and get customer feedback about the app and see how customers are using it, we're actually going to capture incremental insights as a result of having it out there.

Sean Wondrack - *Deutsche Bank - Analyst*

This is a question that comes up a lot. Are you experiencing tertiary competition against the likes of Uber and Lyft, and would you characterize them as a threat to the rental car industry? If not, why? If you could just explain that, please?

David Wyshner - *Avis Budget Group, Inc. - President and CFO*

Yes, we really haven't seen any significant impacts of ride hailing on our traditional car rental business. We talked about this extensively on our earnings call in February. We went back and looked at all our 2015 data to see whether some of the transactions -- transaction types that might be most susceptible to replacement by or competition from ride hailing companies were changing at all.

So we looked at short length of rental transactions. We looked at low mileage transactions. We looked at transactions in cities where there's a -- the San Franciscos, and Chicagos, and New Yorks, and Bostons of the world, where there's a high presence of ride hailing companies and high adoption of it. And among all of these metrics, we didn't see anything more than a fraction of a point of impact.

And then as we went through the first half of the year and had first-half data available to us, we did all of the same analyses again, and the results were the same. No more than a fraction of a point impact on our traditional car-rental business.

What I do think is important is that the growth of mobility solutions, whether it's Zipcar, car sharing or ride hailing, is creating a situation where urban residents, where city dwellers have a good range, a better-than-ever range of transportation alternatives available to them. And Zipcar and ride hailing as well as public transportation are all pushing out how long folks are comfortable living in a city without owning their own car or without owning a second car. I think that presents a really good opportunity for Zipcar going forward, as we're really positioned -- well positioned in our Zipcar brand to serve that growing need over time.

Sean Wondrack - *Deutsche Bank - Analyst*

Thank you. I believe you stated in the UK -- I'm sorry, I believe you stated that the UK represents approximately 3% of your global revenue. Have you began to see any impact from the Brexit spill into the auto rental market? And should any weakness arise, what tools do you have at your disposal to help mitigate any pricing or volume pressure?

David Wyshner - *Avis Budget Group, Inc. - President and CFO*

Sure. I think the 3% range for the UK is about right. Clearly, UK residents generate some volumes around the world, including on the European continent and vice versa.

As we look at it, I think the international softness that we saw in August probably had a little bit of Brexit impact in it. It's really hard to distinguish it. And at this point we're not seeing anything particularly significant that we would -- that we could tie to Brexit.

I think over time, we and other multinational operators are all going to watch it very carefully. I think the near-term reaction has -- it turns out to have been overblown, and things have certainly quieted down since three months ago, when the vote first happened and the results came in.

So as we look at it, I think it has the potential to create some softness in the UK economy. But I don't think it's going to be as dramatic as we might have first anticipated, and as a result I don't think it will have a significant impact. What we're going to do to manage is to keep our fleet tight and flexible in the UK and look to manage costs there appropriately, and at the same time continue to serve all of our accounts in that space.

Interestingly, we'd probably get a -- we may get a little bit of a benefit from exchange rates if the sterling is -- if the pound is weak, since our European headquarters are based in the UK. And as a result, we actually have a net cost base in England.

Sean Wondrack - *Deutsche Bank - Analyst*

Thank you, and I appreciate that. At this point, I want to open it up to the audience if you have any questions. I know some people may.

QUESTIONS AND ANSWERS

Unidentified Audience Member

(inaudible - microphone inaccessible)

David Wyshner - *Avis Budget Group, Inc. - President and CFO*

Sure. The question is a little bit about how our balance sheet relates to our business value. I think one of the ways that I find helpful to look at our balance sheet is that we fund as much of the value of the vehicles that we have through the asset-backed markets. And that works out to, typically, a little bit north of 75% of the vehicle assets funded through asset-backed debt.

And the remaining quarter of our fleet is essentially funded with corporate debt. And as a result, while there may not be a lot of book value showing up beyond that, what it points to is that the -- roughly speaking, our equity market value in the $3.5 billion range ends up being the value that one can assign to our non-fleet assets, or our business operations, if you will.

Unidentified Audience Member

(inaudible - microphone inaccessible)

David Wyshner - *Avis Budget Group, Inc. - President and CFO*

Sure. The question is about our American and our European summer trends. And I think as we look at both pricing, which was consistent with our expectations and up year-over-year, and volume that was just a little bit soft compared to what we expected going in, I don't think there was any dramatic trade-off that we made between pricing and volume.

I do think we continue to run our fleet tight. So at the margins, we certainly did take a little bit of price -- or if you will, erred, or came down on the side of price rather than getting involved in some sort of fight for volume that wasn't really there.

I think when we are able to get the numbers for the summer, I don't think our share on airport will have moved significantly. I think we ran our fleet just a little bit tight, and that was helpful to the pricing that we achieved. And I think that sort of approach is very consistent with the way we would want to operate, particularly since it would -- you know, still allowed us to hold our share, and consistent with what we said in the past.

In terms of European trends, as we -- in light of seeing some demand softness, particularly along the Mediterranean in August, I think the approach we are likely to take amid a bit more uncertainty is to defleet a bit more aggressively than we otherwise would.

Again, it's not going to be dramatic in the scheme of things. We have a lot of program cars in Europe, so we have the flexibility to do that. And I would put it in the camp of our normal-course reactions to noise that happens in the marketplace.

There is no strategic or major tactical change in what we're doing, but rather it would be the normal tactical response to things being a little bit different than we might have forecasted. And that's a natural weekly part of our business around the world. We look at our fleets by market each and every week and adjust them based on what we are seeing. And the natural thing for us to do in a number of European markets, both in the UK and along the Mediterranean, would be to tweak in favor of tightness right now -- fleet tightness.

Sean Wondrack - *Deutsche Bank - Analyst*

It's the last question, probably.

Unidentified Audience Member

(inaudible - microphone inaccessible)

David Wyshner - *Avis Budget Group, Inc. - President and CFO*

The question is about vehicle preferences on the leisure side, and what we really see is a great breadth of demand. So one of the big areas of focus for us over the last few years has been diversifying our fleet, in part among manufacturers, but particularly to adjust the mix of vehicles to better meet leisure consumer demand.

We have more SUVs and more minivans in our fleet than we ever have before. And we actually believe we are making better money by doing that. We've introduced pickups in certain markets and do well with those, in addition to having a range of vehicles all the way from subcompacts up to leisure-oriented leisure brands, such as BMW and Mercedes. So we really adjust our -- even though the majority of our -- or the largest, the plurality of our rentals occurs in the midsize sort of standard vehicle, we really are offering a range of vehicles to meet just about every vehicle need that's out there.

I guess that's the last question. I just want to thank everyone, both here in the room and on the webcast, for joining today. And thanks again to Deutsche Bank for having us.

Sean Wondrack - *Deutsche Bank - Analyst*

Thank you, David. Especially for the first presentation, very good job.
